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C O N F I D E N T I A L SECTION 01 OF 02 SANAA 001064

SIPDIS

DEPT FOR NEA/ARP ANDREW MACDONALD
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DEPT OF TREASURY FOR JOANNA VELTRI AND SAMANTHA VINOGRAD
DEPT OF COMMERCE FOR TYLER HOFFMAN AND JOSHUA REITZE
USCG FOR IPSED MIKE BROWN

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TAGS: ECON EPET ENGR EWWT FR KS YM
SUBJECT: YEMEN: NATURAL GAS EXPORT LAUNCH PLAGUED BY
DELAYS, ROYG MISMANAGEMENT

REF: A. 08 SANAA 1923
¶B. MCKAY-BROWN E-MAILS 6/3/09
¶C. SANAA 876
¶D. SANAA 299

Classified By: CDA Angie Bryan, for reasons 1.4(b) and (d).

¶1. (C) SUMMARY. Shipments of liquefied natural gas (LNG) from Yemen to South Korea and the U.S. originally intended to begin in December 2008 have been delayed until at least August 2009, resulting in costly penalties for the export company, Yemen LNG (YLNG), and more than USD 100 million in lost revenue for the ROYG. Factors in the ongoing startup delay include the ROYG's lag in providing adequate coastal defense for the liquefaction plant at Belhaf, a dispute with the upstream ROYG gas provider, tribal unrest during the pipeline construction phase, and the Ministry of Oil's insistence that YLNG hire unqualified local tribesmen to operate advanced machinery. These headaches may scare away much-needed foreign investment in the oil and gas sector. Criticism within the ROYG and in Parliament regarding the amount of Yemen's natural gas allocated to YLNG for export (54 per cent of total reserves) has been muted thus far, but could grow louder if ordinary Yemenis feel they aren't benefiting from the ROYG's gas revenues. END SUMMARY.

ROYG SLOW TO PROVIDE ADEQUATE COASTAL SECURITY AT BELHAF
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¶2. (C) The launch of Yemen's natural gas exports through the Yemen Liquefied Natural Gas Company (YLNG) has been delayed five months and counting, due to inadequate ROYG-provided coastal security at the Belhaf LNG facility, ongoing disputes with the ROYG gas provider upstream and several contractors downstream, and tribal considerations along the pipeline route from Marib. YLNG Deputy General Manager Karim Abuhamed told EconOff on June 5 that LNG shipments to South Korea slated to begin in December 2008 have been pushed back until August 2009 (REF A). Shipments to the U.S., originally intended to start April 2009, will not begin until November 2009 and are contingent upon a forthcoming U.S. Coast Guard foreign port security assessment (REF B). As a result of these delays, YLNG has had to pay daily penalties to its buyers, totaling USD 2.4 million thus far, for failure to deliver gas on time under the terms of the its Sales and Purchase Agreements (SPA's). The ROYG has also suffered from the startup delays, losing out on more than USD 100 million

in potential export royalties.

¶3. (C) The ROYG's numerous delays in providing robust coastal defense at the two-train, 6.7 million metric ton/year Belhaf liquefaction facility, with its two shoreline LNG storage tanks and 800 meter-long loading jetty, have contributed to the overall export launch delay. YLNG Security Manager Gilles Chalancon told EconOff during a May 6 visit to Belhaf that YLNG was unhappy with the Yemen Coast Guard's (YCG) performance in early 2008 and decided to switch to the Yemeni Navy (YNAV), whose vessels currently patrol the waters outside the offshore restricted area. In late 2008, YNAV repeatedly asked YLNG to purchase new patrol vessels for use at Belhaf and, when informed this was not feasible, instructed YLNG to finance the transportation, repair, and fueling of a YNAV vessel stationed at Hodeidah on Yemen's west coast, according to YLNG General Manager Joel Fort. Unconvinced with YNAV's capabilities, YLNG convinced the French Government to send a pair of French naval commandos to train YNAV personnel stationed at Belhaf in May 2009. (Note: French company Total Oil is the majority shareholder in YLNG. End Note.)

DISPUTE OVER GAS QUALITY MEANS MORE DELAYS, PENALTIES
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¶4. (C) Another costly delay has resulted from YLNG's ongoing dispute with SAFER Exploration and Production Operations Company, the national oil company that extracts the natural gas in Marib, over the quality of the feedstock gas. The Gas-Sharing Agreement (GSA) between YLNG and the ROYG calls

for a certain percentage of energy-rich Liquefied Petroleum Gas (LPG) to be included in the content of the natural gas it sends via pipeline to Belhaf, but SAFER has not yet upheld its end of the bargain, preferring to direct the LPG to Yemen's domestic market to be used as cooking gas. If SAFER does not soon increase the percentage of LPG in the feedstock, YLNG will be forced to pay additional fines to its clients under the SPA terms, further cutting into YLNG's profits, according to Deputy GM Abuhamed.

¶5. (C) A number of Post energy sector contacts told EconOff that the SAFER management has long been working at cross-purposes with YLNG, determined to keep as much natural gas underground as possible in order to bolster flagging oil production levels. (Note: Some natural gas in Marib is currently re-injected into oil wells to enhance crude oil extraction rates by increasing pressure underground. End Note.) SAFER is not the only ROYG agency unhappy with YLNG's progress: Ministry of Electricity officials hinted to EconOff their displeasure with the ROYG's generous allocation of natural gas to YLNG for export rather to power plants for domestic use (REF C). Ministry of Trade and Industry officials complain that Yemen should have created a domestic petrochemicals sector using feedstock gas.

TRIBAL CLAIMS AFFECT PIPELINE SITING, BELHAF OPERATIONS
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¶6. (C) YLNG and the ROYG chose the Marib-Belhaf pipeline route, hardly the shortest (and thus most efficient) distance to a coast, in order to traverse the least number of tribal areas possible, according to Ibrahim Abulohoum (strictly protect), GM of the Ministry of Oil's Gas Division. Despite this attempt, the 320-km pipeline runs through areas controlled by 22 different tribes, grouped into four main confederations: the al-Jeda'an, the Jahm, the Murad, and the Abeida. Abulohoum told EconOff on June 5 that kidnappings of YLNG personnel, vehicle seizures, and outright access denial to certain areas were responsible for delays in laying the pipeline. YLNG officials also complain that the Ministry of Oil's plan to increase the percentage of Yemeni employees to 90 per cent has forced them to hire unqualified Yemenis based on tribal considerations. The Ministry of Oil repeatedly

requested that YLNG hire local tribesmen with little or no formal education as operators of multi-million USD control panels and other advanced equipment.

COMMENT

¶7. (C) The ROYG's mismanagement of aspects of the Yemen LNG project -- coastal security, upstream gas operations, and an overly aggressive Yemenization policy -- illustrates the disconnect between the ROYG's oft-repeated desire to attract major international oil and gas companies to Yemen and its abysmal relations with existing firms. The ROYG-caused headaches associated with the YLNG startup will likely serve as a cautionary tale for companies considering bringing much-needed investment in the oil and gas sectors. So far, there has been only limited grumbling from members of parliament (REF D) and within the ROYG regarding the quantity of gas reserves allocated for export rather than domestic use (9.15 of Yemen's 17 trillion cubic feet total reserves). Such resource nationalism could grow more pronounced, however, if ordinary Yemenis perceive they aren't benefiting from the ROYG's gas royalties. YLNG's success will hinge upon the USG's foreign port security assessment of Belhaf, natural gas prices, and security along the pipeline route and coast. END COMMENT.
BRYAN